THE IMPORTANCE OF KEY INDICATORS

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The Relationship of Standards to Key Indicators

Established standards are the levels of performance toward which mental and physical activity is directed. Once established and understood by a group or individuals, standards help bring about the integration of effort and progress.

In order to be meaningful, a standard must be coupled with one or more key indicators. What is a key indicator?

> A key indicator is a piece of essential information about performance, often expressed in terms of a ratio or relationship. When related to a standard, it gives a measurement of the degree to which the standard is being met (performance).

A standard has real meaning only when we use it as a target for performance, and when we have key indicators to tell us how we are doing in relation to the standard.

Most good managers have a small number of standards and key indicators that they watch constantly. These standards may not all be expressed explicitly, but they certainly exist in the minds of the managers or there would be no way to evaluate the performance revealed by the key indicators. What are some of the standards and key indicators in common use?

	Key Indicator	Standard
...In milk production	Number of bacteria per cubic milliliter	200,000 per cu. ml.
...In grain marketing (corn)	% of moisture	15.5%
...In business	Return on investment	12%
...In automotive performance	miles per gallon of gas	20 miles

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The key indicators will vary from job to job, and they may range from casual observation to highly formal reports. Some will give a picture of the performance of a single employee; others will combine in one index or chart a number of factors representing the overall condition of an entire department or section. Some various means of observing key indicators are:

1. Personal Observation

Often the best indicators are those that signal us before performance falls off. Some managers develop a "sixth sense" that enables them to foresee conditions which will adversely affect performance by their subordinates. Often they are hardly conscious of these indicators, but if they studied them a bit, they might use them even more effectively. Here is an example:

> A farmer employed a hired man to help out with work on the farm. The man was a very good worker except for short periods when he would become irritable and unreliable. Upon closer examination the farmer noticed that these periods occurred when his employee's visible supply of chewing tobacco got low. From then on, it was a simple matter to heed this crude but reliable key indicator and to maintain satisfactory performance.

Personal observation, often of actions or conditions only indirectly related to performance, is one important way of noticing key indicators. A common practice is for the manager to "take a walk" through his plant, store, or operating area to see how things are going. His trained eye can quickly give him at least a limited "feel" of the quantity and quality of output, and alert him to conditions that require his attention.

2. Informal Comments by Subordinates

An alert manager can gain valuable clues about performance from the unofficial remarks and observations of the people he supervises. They often point to bottlenecks, personal shortcomings, potential abilities, unnoticed achievements, unsatisfactory targets, and the like. Such remarks also reveal a subordinate's understanding and acceptance (or the opposite) of performance goals and standards.

3. Complaints and Comments From Employees, Associates, and Customers

Another useful source of information regarding performance of subordinates is the things said by the people who work with them or under them, or are served by them. Naturally, a manager cannot take at face value all that these people say. But repeated complaints--or compliments--may well be the sign of a situation worth looking into.

4. Formal Reports

Despite the usefulness of the foregoing types of informal reports for checking on the performance of subordinates, a manager usually needs formal reports too. Some of these may be prepared by people in a staff department such as accounting, personnel, or maintenance. Others may be prepared by outside consultants, a government agency, an association, or a task force committee.

Actually, the general manager does not need to know everything that is going on within the business. When the critical key indicators are available to the manager, he can have the assurance that all essential elements of the firm are "under control". One aim of management controlling should be to furnish the manager with the smallest amount of vital information that is needed for making major decisions. This is accomplished by carefully selecting a small number of key indicators that sensitively measure the vital aspects of the business. If he is aware of performance in the crucial aspects of the business. he will be in a position to know when performance is satisfactory, to spot trouble in time to take corrective action, and to make key decisions with assurance.

The Nature of Key Indicators

Key indicators may be expressed in many ways. Frequently they are in the form of ratios or relationships (miles per hour, cost per ton, number of trips per truck, etc.). Such quantitative indicators usually are made available in charts, tables, graphs, and the like. Other indicators--qualitative, intangible ones--are expressed by words denoting characteristics. For example: "Degree of cooperation," "satisfactory."

> Sometimes we become so intrigued with the mechanism that conveys a key indicator that we fail to use the indicator properly. It must be noted that in most cases human judgment must be exercised in interpreting key indicators. They are of little value until they are interpreted and used as a basis for decision making.

Selecting the Purifying Key Indicators

No single key indicator can tell you the entire story about an operation. The use of several key indicators is more likely to give you the essential picture. It is necessary to have indicators selected so that they check on each other. We should weigh cost per mile against the age and use of a vehicle, or quick profit vs. long-term maintenance costs, or performance of individuals against organizational requirements, or credit ratings vs. new business.

Businesses usually have many objectives relating to profit, service, employee development, market penetration and the like. Each of these objectives may to some extent conflict with other objectives. Therefore, key indicators should be set up so that good feedback is received in regard to all objectives of the business. In other words, the total business process must be considered in setting up key indicators. It takes time and careful thought to select and refine key indicators. However, experience with key indicators will help in improving them. They should constantly be evaluated in terms of their accuracy and dependability in reflecting real and total situations, and of their value in the decision making process.

General Management Requirements of Key Indicators

Controlling should not increase the number of reports and records that go to a general management executive. In fact, the aim of good controlling is to keep them to a minimum. Some guidelines for selecting key indicators might be:

1. Select as few as possible. There should be as few as possible, but enough to give full and balanced reporting in a key performance area.

2. Select the key indicators that will help both in present conditions and future projections. Actually, reporting is history; it has to do with past events. The chief value of studying history is to help in plotting properly the future. Key indicators should be designed to help us see where we have been, and enable us to operate in the future without repeating the mistakes of the past.

3. Select key indicators that lead to worthwhile ends. The health and continuity of a business are the constant concern of the effective manager. Key indicators should be selected so that they give feedback that helps the organization or the business and are not merely the reflection of the abilities or personal interests of the manager.

4. Select key indicators that lead to progress and innovation. A business must progress in order to survive. Key indicators should stimulate better performance in the future. They can and should help in plotting a progressive path and should enable the manager to see a little further down the road of the future of his business than anyone else.

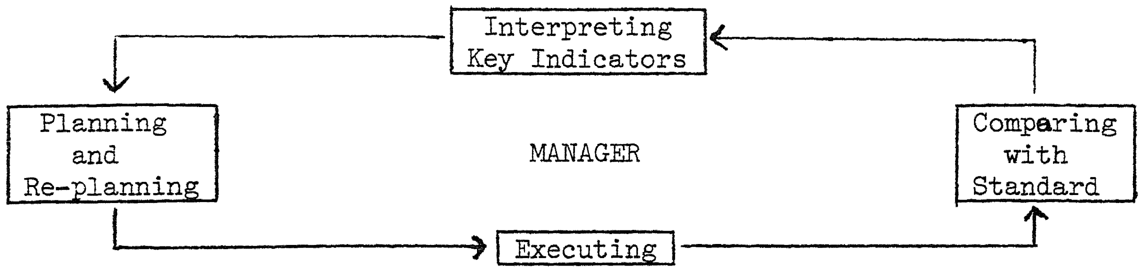
5. Select key indicators that permit ready comparisons. Business is a process, and at any given moment progress must be measured in relation to a starting point, and a goal, a standard, or some other fixed point. Key indicators tell the executive where he stands at a given time in relation to his performance standards. Key indicators ideally provide comparisons with standards without involved interpretation.

An Orderly Cycle

Many times companies operate from one crisis to the next.

CRISIS ⇄ ACTION

From crisis to action, and from action to crisis. Each crisis and action creates more crises and more actions. This would be the case if we were to take action as soon as a key indicator shows that an activity is out of line. A more mature and satisfactory method of managing in any key performance area can be represented as follows:



In this diagram, accomplishment of a given assignment is: 1) planned; 2) carried out; 3) checked against standards; and 4) interpreted in view of available information. Then, if there is need for corrective action, replanning takes place and the decisions arrived at are carried out. This cycle repeats itself as often as is necessary to complete the assignment.

Only the steps labeled "Comparing with Standard" and "Interpreting Key Indicators" are included in the control function. Planning, replanning, and executing are not part of controlling. They are, however, among the activities of a manager who is responsible for a given performance area. If the manager also handles the control function then all four activities in the diagram are his responsibility.

It is important to note that planning and executing are essentially "doing" activities, whereas controlling is a recording, reviewing, interpreting, and advising function. Controlling itself does not make the decisions or issue the orders that determine or initiate corrective action. It provides the planning and executing activities with the tools (information) necessary to keep on the right track.

If an indicator shows that a performance standard is not being met or is being exceeded, the situation must be examined before action is taken. This is the concern of the control function. After examination, replanning must be done before fresh action is taken. Otherwise the manager may change the wrong procedures or fail to make the necessary changes in time.

In Summary

In order to successfully handle his responsibilities, it is necessary for the manager to establish key indicators that are meaningful to him.

They should give essential information regarding performance, be readily understandable, and serve as a dependable basis for decision making.

It takes time to establish good key indicators, but once arrived at, and refined through experience and on-the-job testing, they can spell the difference between business success and failure